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HAROLD B. WILLEY, Clerk

In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 441

346 U.S.
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WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I. duP. BAYARD, RECEIVER,
Petitioners,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY, DEEP CREEK RAILROAD COMPANY, THE WESTERN REALTY COMPANY, THE STANDARD REALTY AND DEVELOPMENT COMPANY and DELTA FINANCE CO., LTD.,
Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

(Following action taken below after remand by this Court in No. 150, Oct. Term 1952, together with appendices containing copy of petition for writ of certiorari in said No. 150 and opinions below after the remand.)

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No .....

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vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY, DEEP CREEK RAILROAD COMPANY, THE WESTERN REALTY COMPANY, THE STANDARD REALTY AND DEVELOPMENT COMPANY and DELTA FINANCE CO., LTD.,
Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Western Pacific Railroad Corporation and Alexis I. duP. Bayard, its Receiver, pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit. Certiorari was granted to review this same judgment in No. 150, October Term 1952.[1] The case was then briefed and argued on the merits. In April, 1953, this Court remanded it for further proceedings, as hereinafter stated more fully.

[1]The record now before this Court is the same record as was before it in No. 150, Oct. Term 1952, plus an additional volume (Vol. VII) containing this Court's mandate and the subsequent proceedings and opinions below. For convenience those subsequent opinions are printed as Appendix II to this petition.

OPINIONS

The opinion of the District Court (R. 258) is reported in 85 F. Supp. 868. Several opinions in the Court of Appeals (R. 2214, 2239, 2260, 2288, 2296) are reported in 197 F.2d 994. The opinion of this Court is reported in 345 U.S. 247. Subsequent opinions in the Court of Appeals (R. 2354, 2356, 2359) are reported in 205 F.2d 374. A still later opinion below (R. 2363) is not yet in the Federal Reporter but appears in CCH Federal Tax Reporter, ¶ 9543, p. 48, 455.

JURISDICTION

The District Court had jurisdiction under 28 U.S.C., Sec. 1331, 1332, and the Court of Appeals under 28 U.S.C., Sec. 1291 and 1294(1). That Court's judgment was entered October 29, 1951 (R. 2255). Later it denied a timely petition for rehearing, struck a timely petition for rehearing en banc, and denied leave to reinstate the latter (R. 2257-60, 2287). Thereafter, this Court granted certiorari, vacated the orders denying rehearing and leave to reinstate the petition for rehearing en banc, and remanded the cause (R. 2321; 345 U.S. 247). On August 20, 1953, the court below again denied the petition for rehearing and denied the petition for rehearing en banc (R. 2362).

QUESTIONS PRESENTED

1. A. Must a former parent corporation join in consolidated federal income and excess profits tax returns with its former subsidiary, so that a loss incurred by the former parent may be used to extinguish the tax liability of its former subsidiary, without any accounting by the former subsidiary to the former parent for the benefit thus obtained? The loss so utilized was the parent's loss of its entire investment in the subsidiary (I.R.C., Sec. 23(g)(2) and (4)).

B. Is this required as a matter of construction of the federal tax statutes and regulations? Do the statutes and regulations require that the benefit of a tax use of a loss must go to one who

did not suffer the loss and preclude it from being used to ameliorate the loss of the party who did?

C. In asking this Court to affirm a railroad reorganization plan which destroyed petitioner's ownership of respondent and gave that ownership to respondent's creditors completely, the creditors urged that respondent's great current income was no support for a continuing ownership interest in petitioner because the huge wartime taxes would largely consume that income. This Court so held in affirming the plan, in *Ecker v. Western Pacific Railroad Corporation,* 318 U.S. 448. The creditors thereafter used the very loss inflicted on petitioner by this Court's decision to avoid paying those very taxes which were a predicate of that decision. Was that not such a misuse of this Court's decision as to make retention of the enrichment of the tax savings unjust to petitioner, is not a denial to petitioner of any equity in the tax savings so achieved by use of its loss erroneous, and do the tax statutes and regulations preclude recognition of any such right in petitioner?

2. Is determination of what fair arm's length bargaining would have yielded, in a case where that issue is relevant, beyond the constitutional scope of federal judicial power?

3. Are claims barred because of non-presentation in railroad bankruptcy (Sec. 77) proceedings, when they arose after revesting of the properties in the reorganized debtor or where, as a condition of revesting, the latter assumed all liabilities of the trustees?

4. Does not a Court of Appeals exceed its appellate office and so far depart from the accepted and usual course of judicial proceedings as to call for this Court's power of supervision [Supreme Court Rule 38(5)(b)], where it finds facts *ab initio* to affirm a judgment which it holds to be non-sustainable on either the legal theories applied or the facts found by the trial court, particularly where its findings are contrary to those which the trial court made clear it would have found had it considered the issues material?

5. Has the court below obeyed this Court's mandate in No. 150, Oct. Term, 1952?

STATUTES INVOLVED

The pertinent provisions of Internal Revenue Code, Sec. 23(g)(2) and (4), 52, and 141, Treasury Regulation 104, R.C.P. 52(a), and Bankruptcy Act, Sec. 77 (11 U.S.C., Sec. 205) are printed in Appendix I hereto.

STATEMENT

This case was before the Court, after grant of certiorari, as No. 150, October Term, 1952. The pertinent facts appear in our Petition for Certiorari there[2] and, in part, in the subsequent opinions in *Western P. R. Corp., et al. v. Western P. R. Co., et al.*, 345 U.S. 247 (April 6, 1953). Briefly, as stated in the opinion of the Court (345 U.S. at 249):

> "The petitioners[3] in these causes—a corporation and some of its stockholders—seek an accounting from respondents—certain other corporations which, prior to a reorganization in 1943, were subsidiaries of the petitioning corporation. It is petitioners' theory that respondents had unjustly enriched themselves by wrongfully appropriating a 'tax loss' incurred by petitioner Western Pacific Railroad Corporation and applying it to the sole benefit of respondent Western Pacific Railroad Company."

Petitioner Corporation (hereafter called petitioner) had owned all the capital stock of respondent Western Pacific Railroad Company (hereafter called respondent) for which it had paid $75 million (R. 262). In 1935 respondent went into bankruptcy, and trustees were appointed, remaining in possession until December 29, 1944 (R. 1908, 1916). The plan of reorganization proposed for respondent by the I.C.C. and sustained by this Court on March 15, 1943 in *Ecker v. Western Pacific Railroad Corp.*, 318 U.S. 448, excluded petitioner from participation in the reorganization and wiped out its $75 million investment.

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[2]A copy of the bulk of that petition is atached hereto as Appendix III.

[3]The petitioners referred to were those in No. 150, who are the petitioners here, and in No. 160, a companion case.

Under the Internal Revenue Code, Sec. 141, a parent company and its subsidiaries may file consolidated returns in which losses of all are offset against the gains of all. I.R.C., Section 23(g)(4), as amended in October 1942, provided for the first time that a loss arising from worthlessness of stock in a subsidiary is an ordinary rather than a capital loss and thus deductible from taxable income. Thereby petitioner's loss, resulting from this Court's decision in the *Ecker* case, became available as an offset against income.

Consolidated returns for 1943 and 1944 and a claim for refund of the 1942 tax were filed, using this loss of petitioner's to offset respondent's income. In 1947 a settlement was made with the Commissioner of Internal Revenue (R. 262). Except for the offset of petitioner's stock loss, respondent would have had to pay an additional $17,201,739 in income and excess profits taxes (R. 2217-8). Thus respondent discharged a tax liability to the government of over $17 million by using petitioner's tax rights.

This remarkable result was, in the words of respondent's tax counsel, "paradoxical" (R. 265), because the loss used to save respondent taxes was the loss sustained by petitioner in losing ownership of respondent, whereby petitioner lost any further economic interest in respondent and could not, as a stockholder, gain any benefit from the discharge of respondent's taxes.

THE RESULT WAS OBTAINED BY RESPONDENT'S TAKING OVER PETITIONER'S AFFAIRS AND DIRECTING ITS ACTIONS.

This result was accomplished by respondent's taking over and managing petitioner's affairs for respondent's own benefit, without regard for the rights of petitioner or petitioner's stockholders. It was able to do these things because it controlled Curry, petitioner's titular president.

As the trial court found, respondent through its tax counsel conceived the idea of using petitioner's loss (R. 261), decided to put the idea into effect (R. 265, 266), prepared all the operative documents and settled the subsequent tax controversy with the

government (R. 262, 263, 470, 1442). Curry signed the documents in petitioner's name. Though he was its president, he received no compensation from it; he had become president, succeeding his predecessor, whose chief clerk he had been, because of its impoverishment (R. 645, 743). Concurrently he was an employee of respondent, either in its office or in the office of its counsel (P. Ex. 2A). He received his entire livelihood from it (R. 530, 532, 1729-33, 1744, 1749). He had no understanding of tax matters, which "were wholly Greek to me" (R. 808), and was described by the trial court who had heard him testify as "just a presiding officer and a sort of figurehead," a description he admitted (R. 646-647). In what he did in the premises he took his orders from respondent's tax counsel, who considered that they were responsible to it alone (R. 1431).

The operative documents were never submitted to petitioner's Board of Directors for consideration or approval (R. 261). Most of the Board consisted of employees, even mere clerks, of respondent, receiving their livelihood from it (R. 1135-1139).[4] Only two had the capacity or financial independence to give competent disinterested attention to petitioner's affairs in any matter in which respondent could have an adverse interest. But not until shortly before the present suit was filed did they learn that petitioner's tax loss had been used in the tax returns and that thereby respondent was discharging its liability for federal taxes (R. 1019, 1022, 1024, 1129, 1132).[5]

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[4]During the material period, nine persons were at one time or another directors of petitioner. One was respondent's switchboard operator, one its stenographer and clerk, and one its clerk, put on petitioner's board to constitute a quorum (R. 1138, 1139). They received no pay from petitioner, nor did three others, also respondent's employees, one of them a director and chairman of respondent's executive committee and one of its trustees in bankruptcy (P. Ex. 2A). Another was a clerk in the latter's employ in another company (R. 1135).

[5]While both (Wood and Osborn) supposed that consolidated returns were being filed, they did not know that petitioner's loss was being used or even that it could be. The right so to use it was first made possible by statute in October 1942. The idea of using the loss to save respondent taxes did not even occur to respondent's tax counsel until May 1943 and then he stated it to be a mere speculation of a possibility, "commented on rather than

PROCEEDINGS BELOW PRIOR TO GRANT OF CERTIORARI BY THIS COURT.

The District Court gave judgment for respondent. By a panel consisting of one circuit and two district judges, the court below affirmed (R. 2214), denied a petition for rehearing and struck a petition for rehearing en banc as unauthorized in law (R. 2260). One judge (Fee, J.) dissented (R. 2239) and requested a rehearing en banc (R. 2261). Subsequently, on July 9, 1952, the court en banc denied a motion for leave to reinstate the petition for rehearing en banc, on the ground, among others, of lack of power to grant such a rehearing without the approval of the panel (R. 2288; 197 F.2d 1013).

GRANT OF CERTIORARI AND DECISION OF THIS COURT.

Certiorari was then sought on the merits, as well as on the en banc question, and was granted without limitation as to issues (344 U.S. 809, and 345 U.S. 247 at 250). The case was thereupon briefed and argued here on the merits. Concluding that the en banc issue warranted a remand, the Court's final decision did not reach the merits.[6] On April 6, 1953, this Court vacated the orders by which the court below had denied a rehearing and leave to file a motion to reinstate the petition for rehearing en banc, and it remanded the case for further consideration of the application for a rehearing en banc after adoption of a procedure for dealing with such matters (R. 2321).

PROCEEDINGS BELOW AFTER THIS COURT'S MANDATE.

May 27, 1953, the court below adopted such a procedure by an addition to its Rule 23 (R. 2353). The new rule recast into terms of practice what the court had stated as a limitation of power in

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suggested * * * since it is paradoxical." (R. 588, 591.) Not until December 1943 did respondent's tax counsel decide that it could be done, and he then advised respondent but not petitioner (R. 1448, 1484). He sent a written opinion on the subject to respondent but sent no copy to petitioner (R. 605, 613, 614, 665).

[6]Mr. Justice Jackson stated that he would reverse on the merits, which he discussed in a separate opinion.

its opinion of July 9, 1952.[7] The rule restored command of the matter of granting a rehearing en banc, in any case, to the division that had heard the cause, and made the panel's willingness to rehear the case a condition precedent to a rehearing en banc.

June 12, 1953, the court below entered an order en banc referring this case back to the division for action under the new rule (R. 2354).[8]

Chief Judge Denman, describing the order as one "in which the Court of Appeals en banc divests itself of its jurisdiction of this

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[7] *Opinion of July 9, 1952 (R. 2294; 197 F.2d at 1015):*

"circuit judges may not intrude themselves * * * upon a court or division on which they have not by order of the court been directed to sit.

"A petition for rehearing in any such case, whatever its form or wording, must necessarily be treated as addressed to and is solely for disposition by the court or division to which the case was assigned for determination. If the court so constituted, or a majority of its members, denies the petition, that ends the matter so far as concerns the Court of Appeals. If it grants a rehearing, it may follow either of two courses: (a) it may, and in all ordinary situations does, rehear the case itself; or (b) it may for reasons thought adequate suggest to the nonparticipating judges that the case is one which ought to be reheard in banc; and if all or a majority of the circuit judges agree, the case is then placed on the calendar for in banc consideration."

Amendment to Rule 23 (R. 2353):

"All petitions for rehearing shall be addressed to and be determined by the court as constituted in the original hearing.

"Should a majority of the court as so constituted grant a rehearing and either from a suggestion of a party or upon its own motion be of the opinion that the case should be reheard en banc, they shall so inform the Chief Judge. The Chief Judge shall thereupon convene the active judges of the court and the court shall thereupon determine whether the case shall be reheard en banc."

[8] The order read:

"Pursuant to the Supreme Court's decision of April 6, 1953, and this court's Rule 23, as amended, it is now hereby ordered by this court en banc that the petition of March 10, 1952, be and is hereby referred back to the division, and that the division be and is hereby designated and assigned to consider that petition and to take such action thereon as may be proper, such action to be in conformity with this court's Rule 23, as amended."

appeal," later filed a separate opinion (R. 2359) in order to note that the question of a rehearing en banc had never been really considered before, to make clear that it was to be considered *de novo* by the division, and to list a number of factors that the division ought to take into consideration, namely:

> "(a) That the case is described by the Supreme Court as 'difficult and complicated litigation,' p. 19 slip opinion, and that it is 'as complicated as it is unique,' p. 1.
>
> "(b) That the amount involved in the case is stupendous, being $21,000,000, and that the issues are very intricate such as might invoke the pooled wisdom of all the circuit judges as stated in the opinion of Mr. Justice Frankfurter at page 4.
>
> "(c) That the Supreme Court deems this case so important that it granted certiorari on the merits as well as on the question of rehearings en banc."

Judge Pope dissented from the order of June 12th (R. 2356), stating that the order "means that if the division is of the same opinion it was before then the case is at an end." Since the new rule was not in effect when the pending petitions were filed, he believed that

> "To apply such procedure retrospectively in the circumstances of this case would * * * be an abdication of the duty which this court owes to these litigants.
>
> "* * * it is the duty of this court, as now constituted, to spare no effort to bring this important litigation to a right conclusion. We have here a case involving an apparently novel point of law. To date the judges who have considered its merits are equally divided as to who should win. Mr. Justice Jackson and Judge Fee think the plaintiff should prevail. Judge Healy and Judge Byrne think otherwise. There remain six judges of this court whose power to break this tie is clear. The question is, is it our duty to do so? I think it is. I cannot think of a situation more clearly requiring action rather than abstention, decision rather than avoidance. The case is now in our hands as a full court. I think it is our duty to keep it there, to hear arguments on it, and to decide it."

By reason of the order of June 12th, "the original petitions for rehearing and rehearing en banc [came] again before [the division] for disposition" (R. 2364).

August 20, 1953, both petitions were denied (R. 2362). However, "Judge Fee did not participate in this determination" (R. 2362, 2373). Judge Fee was the member of the division who had dissented from the original decision. Thus a two judge panel, without the cross-fertilization of judgments that could come from participation of even a third judge, precluded further consideration by the court of the desirability of a rehearing en banc. The "function under [28 U.S.C.] Section 46(c) [was] discharged definitively" by two judges, the very two "whose judgment may call for *en banc* action."[9]

The order of August 20th denying a rehearing and preventing a rehearing en banc was accompanied by an opinion (per Healy, J.) (R. 2363). It falls into two sections, one addressed, in effect, to the opinion herein of Mr. Justice Frankfurter, and the other explicitly addressed to the opinion of Mr. Justice Jackson.

THE FIRST SECTION OF THE OPINION OF AUGUST 20TH.

As a succinct statement of factors relevant to the issue of whether a rehearing en banc was appropriate, the following passage from Mr. Justice Frankfurter's opinion (345 U.S. at 270) had been called to the court's attention by us (R. 2333) and to the panel's attention by Chief Judge Denman (R. 2361):

> "determinations *en banc* are indicated whenever it seems likely that a majority of all the active judges would reach a different result than the panel assigned to hear the case or which has heard it. Hearings *en banc* may be a resort also in cases extraordinary in scale—either because the amount involved is stupendous or because the issues are intricate enough to invoke the pooled wisdom of the circuit."

The opinion of August 20th does not mention the question whether a majority of all the active judges might reach a different

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[9]This is a paraphrase of a passage in Mr. Justice Frankfurter's opinion in *Western P. Corp. v. Western P. Co.*, 345 U.S. 247 at 272.

result from the panel.[10] As for the other factors, the opinion does not deny their presence. It simply denies their relevance to the granting of a rehearing en banc, in any case.[11] Nor is there any mention of the fact that the legal questions on the merits in this case have been described by several judges during the course of the appeal as "serious and important" "affecting the fields of bankruptcy and taxes,"[12] "important litigation,"[13] "interesting questions" involving "federal bankruptcy proceedings and federal tax rulings,"[14] "intricate,"[15] or of the fact that they have been deemed of such interest to the law as to be the subject of two law

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[10]Only one judge on the panel was eligible to sit en banc, the others being district judges. On August 20th there were but six judges eligible to sit en banc, there then being but 6 active circuit judges, Judge Mathews having resigned (28 U.S.C. Sec. 46c). Only three of the six had expressed any views, and of these three Chief Judge Denman and Judge Pope had indicated that the merits were not a closed matter. Thus, of six judges who have made any statement on this subject during the appeal, 2 have stated that petitioner should prevail on the merits, 2 have indicated that it might, and 2 that it should not. Yet the latter 2 have foreclosed consideration by the 6 active circuit judges.

[11]It states that rehearings en banc will be granted only in case of an intra-circuit conflict or where the public has an interest (R. 2364), without stating any test of the latter. As examples of public interest it cites (R. 2364, fn. 4) two cases, which the opinion of July 9, 1952 (by the same judge) had described as "nondescript matters" (R. 2294, fn. 6).

The opinion of August 20, 1953 further states (R. 2366) that "unless the gates are to be opened to a flood of horizontal reviews it seems essential that we adhere to the principles which have guided us in the past." The opinion of July 9, 1952 had said (R. 2292, fn. 4), "There are no definite criteria that we know of by which to determine what cases are suitable for in banc consideration."

Cf. Judge Maris, "Hearing and Rehearing Cases in Banc," 14 F.R.D. 91. Noting this Court's decision herein, 345 U.S. 247, he says, "the fears of the Court of Appeals of the Ninth Circuit expressed in the Western Pacific Railroad Corporation case, 197 F.2d 994, 1015-1016 that the procedure would be burdensome and crippling to the administration of the court have not been borne out by the experience of the Third Circuit." (p. 96)

[12]Judge Fee, R. 2261.

[13]Judge Pope, R. 2357.

[14]Mr. Justice Jackson, 345 U.S. at 275, 276.

[15]Chief Judge Denman, R. 2361.

review articles,[16] and that the rights of more than 4700 people on petitioner's side are at stake (R. 659).

SECOND SECTION OF THE OPINION OF AUGUST 20TH.

The second section of the opinion of August 20th is addressed to Mr. Justice Jackson's opinion herein (345 U.S. 273) and is prefaced by the statement, "Our respect for the pronouncements of the Justice will not permit us to leave his comments unnoticed" (R. 2367). It endeavors to show error in Mr. Justice Jackson's reasoning and conclusion that petitioner is entitled to prevail on the merits. In the course of the effort and as buttresses for its original decision, the court seizes upon grounds and uses reasoning not relied on, or even mentioned, by it in that decision, and therefore not argued in the petition for rehearing. The opinion of August 20th is thus another opinion on the merits and would seem to have been more appropriate to a decision rendered after a rehearing had been granted than to an order denying rehearing. Such an order completely precluded argument of the new matter, and thereby, we feel, precluded the adequate consideration the case warrants, particularly since it discusses and sharply rejects Mr. Justice Jackson's views and reasoning, expressed after the original decision which the court declined to rehear, without giving petitioner an opportunity to be heard in respect of those views.

REASONS FOR GRANTING A WRIT

This Court knows best whether the court below has obeyed its mandate in No. 150, Oct. Term, 1952; on that question, we shall add nothing to the Statement of what occurred after the remand [But cf. views of Clark and Frank, Ct. JJ., in *In re Sacher*, 206 F.2d 358, 366 (2 Cir., Aug. 20, 1953)].

In the following pages we pray that the Court review the case on the merits.

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[16]38 Cal. Law Rev. 946; 65 Harvard Law Review 1256. The article in 5 Stanford Law Review 332, cited in Mr. Justice Jackson's opinion, is confined to the en banc question.

The opinion denying rehearing after that remand reasserts the views that gave rise to the questions on the merits presented in our Petition for Certiorari in No. 150, Oct. Term, 1952. The grant of certiorari there included those questions. Since the Court's subsequent decision did not reach the merits, being rested on the *en banc* issue, these questions are now re-presented as Questions 1A and 4. The latest opinion below also endeavors to support the decision by additional reasoning which not only sharpens those questions and makes the necessity to review them more acute but gives rise to further important questions.

Since reasons for reviewing the merits were stated in our petition in No. 150 and the case was thereafter fully briefed and orally argued in this Court in December 1952, we attach a copy of that petition as Appendix III, summarize its substance, and note the bearing of the new reasoning below.

This case involves the legal consequences attaching to the filing of consolidated tax returns under federal tax laws, the construction of federal tax statutes, the consequences of railroad reorganization under federal bankruptcy laws, the proper delimitation of the appellate office as respects the fact finding function, and a novel limitation of federal judicial power. Proper accounting between the innumerable corporations filing consolidated returns depends on a correct decision. The decision below is in conflict with decisions of other circuits and with applicable decisions of this Court, and it is diametrically opposed to the views of a Justice of this Court in this case on an important issue of statutory construction and in an important field of law. Unless the issue is settled authoritatively, it will breed complex litigation in ever-widening circles.

I.

The Decision Rests on a Novel Rule of Law Affecting Taxes and Corporate Reorganization and a Novel Construction of the Federal Tax Laws Concerning Consolidated Returns.

The essential ground of the decision is its announcement of a new principle of law, viz: That wherever the tax laws permit two corporations to join in consolidated federal tax returns, and one

has a loss and the other has income, the former must join with the latter and permit its loss to be used for the latter's benefit, and without payment, consideration or compensation.

And since, "when the returns and the claim for refund were filed, affiliation no longer existed" (R. 2230-1), the principle as applied went further, namely: A former parent is under a duty to join in a consolidated return and permit its loss to be used to satisfy a former subsidiary's tax, without compensation, even though it has no economic interest in the latter and can derive no benefit therefrom.

This is tantamount to holding that the income corporation can sue in equity for a mandatory injunction to compel the loss corporation to join and confer the benefit of its loss, gratis.

As shown in our petition in No. 150, October Term 1952[17], this basic holding is inconsistent with the rationale of consolidated returns and the purpose of Congress in allowing them, it makes mandatory what Congress left optional, and it thereby conflicts with decisions of the Second Circuit and the Fourth Circuit.

The true rule, we submit, is that expressed by Mr. Justice Jackson when this case was last here (*Western P. R. Corp. v. Western P. R. Co.*, 345 U.S. 247, 277):

> "Congress has authorized, but has not required, that these two be merged by means of a consolidated tax return. Each has the right, but no legal duty, under federal law to join in consolidated returns.
>
> * * * * * * *
>
> "Each of these corporations had something to contribute to a tax saving plan. Either alone was helpless. But I know of no moral or legal obligation to give away any legal opportunity or advantage just because its owner cannot utilize it himself.
>
> "There would have been nothing remotely illegal or improper if the management of the plaintiff corporation had demanded some compensation for its loss privileges. Indeed, it is probable that the intention of the statute permitting the consolidation of the two positions was to provide salvage for the loser, not profit for one which sustained no loss."

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[17]Pp. 3 to 13, Appendix III hereto.

THE LAST OPINION BELOW GOES TO A FURTHER EXTREME BY STATING ITS NOVEL RULE AS A MATTER OF CONSTRUCTION OF FEDERAL TAX STATUTES.

The last opinion below rejects Mr. Justice Jackson's observations and reasserts the basic views of the decision of October 1951 thus (R. 2369):

> "In our decision we discussed the obligations of a holding company to its subsidiary and creditors, and its duty not to attempt to appropriate to itself an advantage *which the tax laws give the subsidiary.*"

Bolstering its decision by new reasons, the court first prefaces them with the statement that it does so "without intending to detract from the soundness of that principle" (R. 2369), and then, in the very course of stating its new reasons, carries its basic holding further. The decision of October 1951 had not made clear whether the supposed duty on petitioner's part to give the tax utility of its loss to respondent was based on a construction of the tax statutes or extracted from some notion of equity. But the latest opinion rests the duty *on a construction and interpretation of the federal tax laws,* for, as noted, it speaks of the "advantage" as one "which the tax laws give the subsidiary," and further states (R. 2371):

> "They [appellant] did not threaten to repudiate the established practice of past years and deny to the creditors *an advantage that the tax laws gave them,* nor did they demand tribute for their cooperation. With full knowledge of all the facts surrounding the transaction appellant chose to follow the custom of previous years and *permitted the tax advantage to fall where the tax laws ordained.*"[18]

This is an outright holding that the tax statutes required petitioner to give the utility of its loss to respondent. It may be contrasted with Mr. Justice Jackson's view that

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[18]As for the statement in the quoted passage about appellant's alleged full knowledge, see pp. 5, 6, supra. The subject of "past practice" adverted to here and elsewhere in the opinion of August 20, 1953 is commented on in our petition for certiorari in No. 150, Oct. Term 1952 (pp. 20, 21 of Appendix III hereto), and our main brief in No. 150 at pp. 121-124.

> "it is probable that the intention of the statute permitting the consolidation of the two positions was to provide salvage to the loser, not profit for one which sustained no loss." (345 U.S. at 277)

The extreme to which the court has now gone finds illustration in a comparison of its reasoning with that of the District Court. Petitioner has contended, among other things, that the only way in which the tax statutes can make sense in permitting petitioner's loss to be used to offset another's income for tax purposes is either to recognize a purpose in Congress that the tax savings should go to the parent corporation who had suffered the loss, to ameliorate it, or else to recognize an equity in the parent to receive the savings as such an amelioration.[19]

The District Court believed that the Treasury ought not to have permitted the tax savings at all. It said (R. 270):

> "To assume * * * that the Congress intended * * * to statutorily authorize what was done in this case is to attribute plain stupidity to the Congress of the United States—an unthinkable procedure despite the general habit of criticism both fair and unfair."

and

> "If I had the power * * * I would order these taxes paid to the United States."

It characterized the tax savings as "amazing and undeserved" (R. 276). For that reason, strangely, it held for respondent. As Judge Fee described this holding, because the trial court believed "that the 'tax escape' was a fraud upon the government" it gave the proceeds to the "wrongdoer" (R. 2239-40). The consequence was that the revenue laws were made absurd, an inadmissible result under rules of statutory interpretation often stated by this Court.[20]

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[19]See pp. 42, 43 of our brief, filed in this Court herein in No. 150, Oct. Term 1952, after certiorari was granted.

[20]Many of the decisions are collected by Judge Learned Hand in *Cabell v. Markham*, 148 F.2d 737 (2 Cir.). A Congressional purpose as to who should have the tax savings, apparent from its enactment, should be given effect. Cf. *United States v. Hutcheson*, 312 U.S. 219, 235; *Van Beeck v. Sabine Towing Company*, 300 U.S. 342 at 351.

Denouncing the trial court's reasoning in strong terms,[21] the court now holds that the tax laws not only tolerate this strange result but command it; it holds that the tax laws not only do not require the benefit of the use of a loss to go to alleviate the burden of the loss but also that they will not even permit that alleviation.

THE CONSTRUCTION BY THE COURT BELOW OF THE TAX STATUTES PRECLUDES RECOGNITION OF THE EQUITIES, ALL OF WHICH ARE WITH PETITIONER, INCLUDING THE FACT THAT THE USE OF THIS COURT'S DECISION IN THE ECKER CASE TO AVOID TAXES PRODUCED A RESULT CONTRARY TO AN ASSUMPTION ON WHICH THE ECKER DECISION WAS RENDERED, MAKING THE RESULTING ENRICHMENT UNJUST.

Respondent has been enriched by the use of petitioner's rights. The retention of that enrichment is unjust

(1) because it is inconsistent with the rationale of consolidated returns and the purpose of Congress in allowing them; and

(2) because respondent was able to and did appropriate petitioner's rights by virtue of a fiduciary and dominating relationship toward petitioner. These reasons were fully discussed in the briefs filed herein when the case was last before the Court, and we shall not amplify them here. But the enrichment is unjust for still another reason which ought to be mentioned because it involves the use of this Court's own decision.

When the I.C.C.'s Plan of Reorganization for respondent was before this Court in *Ecker v. Western P. R. Co.*, 318 U.S. 448, the plan's opponents contended that the huge wartime earnings altered the factual predicate on which the proposed destruction of petitioner's ownership equity was based. The plan's supporters asked that "that issue * * * should be faced squarely by this

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[21]The opinion of August 20th states (R. 2368, fn. 7):

> "Lurking in the background of this case is a specious element which has no proper place in the decision, but which, when injected by innuendo, casts its shadow across the record. There is an insinuation that the creditors received a windfall of millions of dollars at the expense of the United States by reason of a loophole in the tax laws."

This element was more than one lurking in the background of the case; it was the very warp and woof of the District Court's decision, which the court below affirms.

Court," but urged that the argument took "no account * * * of the increasingly heavy Federal income and excess profits taxes necessarily resulting from the very facts which give rise to the increased revenues."[22]

This Court then, "in the interest of advancing the solution of as many problems in reorganization as possible * * * deliberated upon the effect to be given these unexpectedly large earnings," and, in upholding the plan, noted that the "effect of taxation is not wholly answered by deductions of tax estimates on the basis of present rates" (318 U.S. at 507, 508). In the Milwaukee Reorganization case, decided the same day,[23] a similar problem was discussed more fully, and the Court concluded that the "bulge of war earnings" furnished no standard, because, among other reasons, of "the great increase in taxes."

Thus respondent's creditors, in seeking to sustain a plan that gave them petitioner's ownership, minimized the war earnings on the ground that they would largely be consumed by taxes. Succeeding in inflicting upon petitioner its loss, the creditors *thereafter* conceived the idea of using that very loss to avoid the payment of those very taxes.

We submit that such a use of this Court's decision in the *Ecker* case is an additional reason why retention of the enrichment would be unjust, and that the decision below, by cutting off any recognition of equities flowing from this fact, calls for review by this Court.

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[22]Brief of Institutional Bondholders Committee, pp. 61, 62. The brief continued by pointing out that the full impact of taxes awaited passage of the 1942 Revenue Act. Under the tax rates contained in the bill then pending, "the Federal income tax payable with respect to [1942] earnings would be approximately $1,500,000" and would reduce to $2,600,000 "an apparent war boom figure of $4,108,290. * * * Even this figure is before deducting for any excess profits tax which may be imposed upon the reorganized Western Pacific at the current earnings level, depending upon tax legislation as finally enacted."

In fact, but for use of petitioner's tax credits the tax for 1942 would have been $4,201,821 and for 1943 and 1944 over $17 million.

[23]*Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & P. R. Co.*, 318 U.S. 523, 543.

It will be remembered that when the reorganization plan was proposed in 1939 and approved by the Bankruptcy Court in 1940 (R. 1666, 1673), and when the *Ecker* case came on this Court's docket, the use of petitioner's loss, which consummation of the plan would inflict, as an offset to anyone's ordinary income was not yet legally possible, the statute that later made it so being enacted in October 1942. It will be remembered, too, that at the time of the *Ecker* decision the idea of using petitioner's loss to offset respondent's income was not yet conceived (see p. 5, and fn. 5a p. 6, supra). Thus the reorganization plan did not provide that respondent or its creditors should have the use of petitioner's loss, gratis or otherwise. Moreover, as will be noted, it could not have done so if it would.

It will be further remembered that the plan denuded petitioner of every interest in respondent, doing so for the benefit of respondent's creditors. To them it gave petitioner's ownership, which cost petitioner $75 million, and additionally it wiped out petitioner's claims as a creditor amounting to $7½ million. No other creditor was so treated (P. Ex. 20A, pp. 11 and 19; P. Ex. 20C, pp. 10-12).[24] The pre-organization creditors thus were given every interest in respondent or claim against it that petitioner had prior to the consummation of the reorganization plan.

Thereby petitioner suffered its huge loss. The opinion of August 20th intimates that these creditors somehow had an equity entitling them also to seize for their benefit petitioner's loss so inflicted. Thus it asserts that petitioner (R. 2368)

> "is claiming moneys which were earned through the operation of railroad properties in a trust estate administered for the benefit of unpaid creditors of its former wholly-owned subsidiary."

and that (R. 2369):

> "The title to and possession of the railroad properties were in the reorganization trustees who administered the operating

[24]Except a wholly owned subsidiary of petitioner which had a claim of only $61,667. Petitioner and this one subsidiary were the only unsecured creditors, and only unsecured creditors were denied participation in the reorganization. (See *Ecker* decision, 318 U.S. at 455, 466.)

company under the supervision of the United States District Court for the benefit of the unpaid creditors."[25]

In limine, it may be said that this tacit assumption that the old creditors remained unpaid, after wholly supplanting petitioner as owner of respondent, is unwarranted in fact. Other than petitioner,[26] the creditors were secured creditors. They received a 100% equivalent on the basis of stock values assigned (see *Ecker* opinion, 318 U.S. at 455, 461, 481, 487), except one of the James Interests, and its claim was scaled down by less than $3½ million (R. 2022). No finding was sought or made in the District Court on any issue whether the former creditors were unpaid. That court thought the issue wholly immaterial and rejected evidence on the subject (R. 1581-1583). Yet the court below buttresses its decision by an assumption of fact not found by the trial court. As we shall show in Part IV, this is not the only example of that kind.[27]

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[25]The passage continues:

"These creditors had acquired their equities at a time when the operating company was wholly owned and controlled by the appellant."

The fact is that petitioner was controlled prior to respondent's bankruptcy by the James Interests, who owned 61% of its common stock and only 8.8% of its preferred stock. These were the controlling human agents. As the result of respondent's reorganization the James Interests became the controlling power in respondent (P. Ex. 1). The effect of a judgment for respondent will be that the James Interests or their successors, common stockholders in petitioner, will benefit from the tax utility of petitioner's loss in preference to petitioner's preferred stockholders.

[26]And the one small creditor mentioned in footnote 24.

[27]The extraordinary position enjoyed by those creditors is shown by a few figures.

The plan did not contemplate that the reorganized respondent would emerge from bankruptcy with any surplus at all. But it emerged with an unappropriated earned surplus of nearly $30 million. (P. Ex. 20D, p. 15) The capital structure fixed by the plan was devised by the I. C. C. so that the reorganized Company would be able to pay an annual dividend of $3.00 per share of common stock out of the income it could reasonably expect to earn (R. 2179 at 2190; also see *Ecker* decision, 318 U.S. at 506, 507). But in 1943 it earned $27.99 per share of common stock, after setting aside $7,100,000 as a reserve to pay the very taxes it later saved by using petitioner's loss, or $50.24 before setting aside the reserve, and in 1942 it earned $20.28 per share (R. 2179 at 2189). Were it thought to be material, it can

Apart from the facts, the court's assertion is unsound law. That a railroad has once been in reorganization cannot mean that it may take and use another's property rights, gratis. Through a reorganization creditors of a company may permissibly supplant the former shareholders as the owners, as they did here, because the weight of debt submerges the equity of ownership, but they have no right to appropriate still other property of the former shareholders, in order to pay their claims.

Suppose respondent had discharged its tax liabilities with cash taken from petitioner or with the proceeds of shares in some other company owned by petitioner and seized by respondent, say U. S. Steel stock. Certainly respondent would have to compensate petitioner. Yet it could be said, with as much verity as the court below has stated here, that the payment would come out of respondent's "earnings." But such a statement would be a mere play on words.

All this is so obvious that the court's reasoning must rest on other assumptions. It asumes that petitioner was under a duty to join in consolidated returns and use its loss for respondent's benefit, and that petitioner, in asking that the benefit of the tax savings be adjudged to belong to it, is seeking an equity or value for its former stock ownership. But these are false assumptions. The consummation of the plan of reorganization stripped petitioner of that ownership and every other interest, but left it with its loss. The tax utility of the loss, created by Act of Congress, belonged to petitioner, who had become an economic stranger to respondent. After this Court decided the *Ecker* case respondent then seized that tax utility for itself. The Plan of Reorganization

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be shown that in every year since 1943 and to date respondent has earned, after preferred participation, more than $3.00 per share of common, averaging $6.30, and will approach $9.00 in 1953. (20 Standard Listed Stock Reports, No. 201.)

During the trusteeship $30 millions of operating revenues were used for additions and betterments, and another $6 millions of operating revenues were used to replace old equipment (P. Ex. 20C, p. 9). The remaining income from the effective date of the plan until December 31, 1943 was sufficient to meet all bond interest and to make all required payments into the capital fund and sinking fund and still leave $20,658,938 (R. 1196).

not only did not even contemplate any such seizure, but it could not have so provided. *Callaway v. Benton*, 336 U.S. 132.

After the federal bankruptcy laws have wiped out a corporation's entire investment in a subsidiary, neither the bankruptcy laws nor the tax laws intend that it be further stripped of its sole remaining asset, to further fatten the subsidiary's quondam creditors. The old creditors took everything—the sinews and the flesh—and no equity entitled them to pick petitioner's bones as well. Yet this is precisely what the court below has held.

THE BASIC HOLDING PERMEATES THE LAST OPINION.

The basic assumption that petitioner was under a legal duty to give its tax loss to respondent underlies a variety of supposedly independent reasons in the last opinion. For example, it underlies the repeated use of derogatory phrases about petitioner's demanding "tribute" or "exacting payment as a price" of cooperation (R. 2369, 70, 71).[28] A concise answer to this lies in the words of Mr. Justice Jackson (345 U.S. at 277):

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[28]As another example, after stating that it did not retreat from its basic decision, the court proceeded to say that in order for petitioner to recover (R. 2370):

> "* * * we must further assume that * * * the right to claim a tax offset which springs from ownership of stock that is completely worthless is not destroyed when the right to use the loss is determined to have a value of millions of dollars for bartering purposes."

The fact that Congress allows deductions for loss compels that very assumption; any deductible loss is *per se* valuable by Congressional mandate. Yet in the quoted passage the court below intimates that if petitioner should receive anything for the use of its stock loss, the stock would thereby have value, there would be no total loss, and the loss could not be used as a deduction. But the stock and the loss were two different things. The destruction of the stock created the loss. The tax laws then gave a value to that loss for certain purposes. As stated by Mr. Justice Jackson (345 U.S. at 276), "But it is not the loss; it is the right to use the loss as an offset that is valuable." Self evidently the fact that the sustaining of a loss is ameliorated by a tax utility does not mean that the loss did not occur.

If recognition of value in the use of the loss for tax purposes means that there is no loss, not only would no loss resulting from total worthlessness ever have a tax utility, but the result would necessarily be the same whether the petitioner obtained the benefit or respondent retained it. The only way to uphold the tax deduction if respondent benefits while denouncing

"Each corporation then had a bargaining position. * * * each had an indispensable something that the other was without. * * * Each of these parties had but one key, and how can it be said that the holder of the other key had nothing worth bargaining for? * * *

"* * * On the face of it, the conclusion would seem warranted that the plaintiff is entitled to what fair arm's-length bargaining would probably have yielded. To ask this can hardly be stigmatized as capitalizing mere nuisance value. This is not the blackmailing transaction which offers to forego doing another injury if bought off. This merely seeks a share in the benefit which it transferred."

II.

Federal Judicial Power Is Not So Impotent as the Court Below Holds

Addressing itself to Mr. Justice Jackson's statement, just quoted, that "plaintiff is entitled to what fair arm's-length bargaining would probably have yielded," the last opinion below expostulates (R. 2372, 2373):

"How could the courts remake the contract for the parties?[29] How could this court or the district court determine 'what fair arm's length bargaining would probably have yielded'? Bargaining presupposes negotiations to determine the maximum amount a buyer is willing to pay and the minimum amount a seller is willing to accept. Such activity is a matter of business administration, and is not a judicial function. A district court, like the court of appeals, is a constitutional court and 'neither has any power or function other than what is strictly judicial.' "

This is a holding that, where one takes from another a thing of value, he is under no legal duty to pay, because courts are impotent to make agreements. It is a limitation of the judicial power of federal courts and on purported constitutional grounds.

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it if petitioner does is to assume that Congress's purpose in permitting the loss be used as a tax deduction was not to ameliorate the impact of the loss upon the person sustaining it but to confer a windfall on one who had no loss at all! That is precisely the holding below.

[29]There was no contract to *remake* because there was no contract. Simply and bluntly, respondent took over and managed the entire tax matter for its own benefit by controlling and directing petitioner's officers and agents.

Courts have been determining questions like these ever since 1602 when *Slade's Case*, 4 Coke 92b, gave rise to actions on a *quantum valebat* or *quantum meruit*:[30] where parties have failed to agree upon the compensation for goods sold or services performed, the very essence of the judicial function is to determine fair value. In innumerable other contexts courts must determine fair value, and the generalized definition of fair value is the "amount of money that can be obtained or must be given in exchange therefor by bargaining," 5 Corbin on Contracts (1951), p. 35, Sec. 1009.

As stated in just compensation cases under the Fifth Amendment, fair value is the "amount that in all probability would have been arrived at by fair negotiations between an owner willing to sell and a purchaser desiring to buy," *Olson v. United States*, 292 U.S. 246, 257.[31] Precisely the same test, in identical or almost identical words, will be found in authorities touching every field of law—e.g., conversion of personalty,[32] breach of contract to sell realty and personalty,[33] taxation,[34] bankruptcy,[35] disposition of all the assets of a corporation at an allegedly unfair price (a matter of close analogy here),[36] and state eminent domain cases.[37]

So also, in a variety of situations not involving valuation of property, courts must and do determine what would have been a

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[30]Plucknett, Concise History of the Common Law (4th ed. Butterworth) 610, II Street, Foundations of Legal Liability, 200; III Street 184, et seq.

[31]Also *United States v. Powelson*, 138 F.2d 343 (4 Cir.). The determination of this issue is a judicial function, *United States v. New River Collieries*, 262 U.S. 341.

[32]Bowers on The Law of Conversion (1917) p. 473.

[33]E.g., *Maxon v. Gates*, 136 Wis. 270, 116 N.W. 758, 765, (1908); *Joseph E. Seagram & Sons v. Bynum*, 191 F.2d 5, 11 (8 Cir.).

[34]E.g., *Whitlow v. Commissioner*, 82 F.2d 569, 572 (8 Cir.); *A. & A. Tool & Supply Co. v. Commissioner*, 182 F.2d 300 (10 Cir.).

[35]E.g., *Huber v. Moran*, 140 F.2d 823, 824 (8 Cir.).

[36]*Allied Chemical & Dye Corp. v. Steel & Tube Co.*, 14 Del. Ch. 64, 122 A. 142, 144.

[37]29 C.J.S. 974.

fair bargain,[38] as in transactions between dominating and dominated corporations or between interlocking directorates. In such cases, as said in *Pepper v. Litton,* 308 U.S. 295, 306,

> "The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain."

Not only may the contract be set aside, *Pepper v. Litton,* supra at 307, but the court may order one to pay another what an arm's length bargain would have reached. Cf. *Chelrob v. Barrett,* 57 N.E. 2d 825, 293 N.Y. 442; 61 Harvard Law Review at 339.

DIFFICULTIES IN DETERMINATION MUST BE RESOLVED AGAINST RESPONDENT, WHO CAUSED THEM.

If difficulties may be encountered in determining what an arm's length bargain would have been, that is no obstacle. The court simply takes "into account all considerations that fairly might be brought forward and reasonably be given substantial weight in such bargaining." *Olson v. United States,* supra, at 257. If the difficulties are insuperable, petitioner should receive the whole of the tax savings, for the reason why no bargain was made was that respondent denied petitioner the opportunity of seeking a bargain by unilaterally seizing and using the loss. *Meinhard v. Salmon,* 164 N.E. 545, 249 N.Y. 458 (per Cardozo, C. J.). This, too, is an old principle, *Armory v. Delamirie,* 1 Str. 505, 1 Smith's Leading Cases (Hare & Wallace Ed.) 589, expressed in the maxim *"omnia praesumuntur contra spoliatorem."*

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[38]A recent example in a tax context is *Helvering v. Safe Deposit Co.,* 316 U.S. 56. There taxability depended on whether relatives of a decedent took as appointees or as heirs. They had claimed as both and had settled with other claimants without allocation between the alternatives. This Court remanded the cause to determine what percentage of the settlement should be attributed to each alternative, i.e., to determine what bargain the parties would have made.

III.

Claims Cannot Be Barred for Failure to Present Them in Federal Railroad Bankruptcy Proceedings When They Arose After Revesting of the Properties in the Reorganized Debtor or Where, as a Condition of Revesting, the Latter Assumed All Liabilities and Obligations of the Trustees.

Among the new reasons advanced in the last opinion below in support of its decision, is the following (R. 2372):

> "No claim was presented to that [bankruptcy] court although the final order of discharge was not made until two years after the filing of the consolidated return [sic] claiming the offset."

But this can be no reason for denying petitioner recovery, because petitioner's claims arose *after* the bankruptcy court had returned the railroad's assets to respondent and *after* the trustees had surrendered control of operations (R. 2215). That surrender and revesting occurred on December 31, 1944 pursuant to a "Revesting Order" of the previous November 27th (R. 36).

The claim for refund of 1942 taxes and the 1944 tax returns, using petitioner's loss, were filed thereafter (R. 2217). They were the acts of respondent, not of the trustees.

It is irrelevant that the income to which the documents pertained accrued prior to the revesting. Pursuant to express requirement of the revesting order,[39] respondent assumed the obligation to pay taxes on that income. To meet that obligation it paid the 1942 taxes and set aside reserves of $10,100,000 to pay the 1943 and 1944 taxes, reserves which it still holds to await the outcome of this suit (R. 517, 518, 614, 616, 1818, 1824). After the revesting the liability to pay taxes was the reorganized respondent's, not the trustees', and it, not they, then utilized petitioner's loss and rights to discharge that liability.

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[39] Paragraph 9e thereof provided that respondent must

> "assume liability for, and pay in due course, any and all taxes lawfully due to the United States from the debtor or the debtor's Trustees for any taxable period prior to January 1, 1945 * * *." (R. 36 at 49)

By an "Agreement of Assumption" respondent assumed that liability in the same words (R. 1716).

As respects the 1943 taxes also, petitioner's claim for the tax savings accrued only when there were tax savings, i.e., in August 1947, when the Treasury accepted the returns pursuant to a settlement wholly negotiated and effected by respondent after it emerged from the reorganization (R. 262, 468). And could it be said that the claim arose in any part theretofore, respondent assumed the liability by express agreement.

The revesting order, as stated by Judge Fee (R. 2253, fn. 18), put respondent "under bond to pay all claims against the trustees." It fixed the date of the consummation of the plan of reorganization as December 29, 1944, provided that respondent should be discharged from all liabilities "except as herein provided" (R. 52) and "directed" it to execute an Assumption Agreement in prescribed form (R. 45, 46, 76). That agreement was executed by respondent in December 1944, whereby it agreed to

> "2. Assume any and all outstanding current liabilities and obligations incurred by said Trustees * * * and generally any and all liabilities and obligations with respect to claims of any character whether heretofore *or hereafter asserted* arising out of the possession, use or operation of the debtor's properties by said Trustees, or their conduct of the debtor's business, including liabilities and obligations hereafter arising up to midnight December 31, 1944." (R. 1711, 1713)

Thereby, as a later order recites, respondent "assumed and agreed to perform all * * * liabilities and obligations of the Trustees remaining in effect on December 31, 1944" (R. 1987, 1988).

The court below now holds that claims which arise after revesting, or which are assumed as a condition of revesting, are barred for nonpresentation to a bankruptcy court. Such a rule gives a railroad, once reorganized, a perpetual tutelage, a position of immunity from the consequences of its conduct possessed by no one else. As stated by Judge Fee below it is "inconceivable,"[40] it

[40]"It is inconceivable that a decree of reorganization prevents the company, when released from tutelage, from entering engagements and incurring liabilities. Otherwise, the organization would be perpetual. See *In re Portland Electric Power Co.*, 97 F. Supp. 857, 873." (R. 2252, fn. 10)

is contrary to reason, it conflicts with the Sixth Circuit in a case involving the same section of the bankruptcy act (*Seaboard Air Line R. Co. v. Savannah Union Station Co.*, 181 F.2d 267 (5 Cir.)), and it conflicts with *Texas and Pacific Railway Company v. Johnson*, 151 U.S. 81, 103, where it is said that there is no principle whereby a court

> "could part with its jurisdiction over property by the complete surrender thereof to its owner, and at the same time constructively retain jurisdiction over such property so as in that respect to bind those who would otherwise be unaffected by its orders."[41]

THE CLAIMS WERE NOT DISCHARGED BY ANY ORDER IN THE BANKRUPTCY PROCEEDINGS.

The last opinion below next asserts (R. 2372):

> "The final order of the bankruptcy court provided that the assets of the reorganized company were to be 'free and clear of all rights, claims, liens and interests of the former stockholders * * *' There is no power in the District Court sitting in an independent proceeding in equity to alter, modify or amend the bankruptcy orders."

But what was actually said by the passage in the "final order" here mentioned was that "The court further finds and concludes" that the assets of the reorganized company

> "vested in and became the absolute property of the Western Pacific Railroad Company on December 29, 1944 free and clear of all rights, claims, interests, liens and encumbrances of former stockholders and creditors of the debtor company and all other persons *except as otherwise provided and directed in the order of this Court in this proceeding dated and entered November 27, 1944* * * *." [R. 109]

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[41]Here the reorganization court did not even purport to reserve jurisdiction to supervise claims arising after the revesting. Nor could it. As said in *Reese v. Beacon Hotel Corporation*, 149 F.2d 610 at 611 (2 Cir.): "* * * reservation of jurisdiction beyond what is requisite to effectuate a plan of reorganization is beyond the power of the reorganization court." Here the plan was formulated, approved and confirmed before anything was done that eventually led to the tax savings. Cf. *Callaway v. Benton*, 336 U.S. 132.

This order of November 27, 1944 was the "revesting order" just discussed (R. 36). As noted, it required respondent to assume, and under it respondent did assume, any liabilities arising from the trustees' acts.

Thus, while the bankruptcy court discharged the stockholder's equity *qua* stockholder and such claims as had existed against the debtor prior to the onset of the bankruptcy in 1935, it did *not* discharge liabilities arising from the trustees' operations. On the contrary, the latter were assumed.

This was precisely in accord with practice and the policy of the law in such matters. At the moment of the consummation of any plan of reorganization under Section 77 of the Bankruptcy Act, four possible classes of liabilities may exist: (1) personal liability of the debtor itself for *its* own debts, i.e., those existing at the onset of the reorganization proceedings; (2) liability of the assets in the trustees' hands to pay those debts and to cover the stockholder's equity as stockholder; (3) personal liability of the trustees to pay obligations arising from *their* operations; and (4) liability of the assets to pay the last named class of obligations. The policy of the law upon consummation of a reorganization plan is to discharge or remold claims of the first two classes and discharge those of the third class, but not to discharge the fourth. The integrity of courts and their officers requires that the fourth be preserved. The settled method of doing so in railroad receiverships was to require these to be assumed by the party to whom the assets were transferred.[42] That policy was carried into Section 77.[43] While subdivision (f) thereof provides for discharge of both the debtor and the assets from claims existing at the commencement of the proceedings and for discharge of the trustees personally, it

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[42]*Texas & Pacific Railway Co. v. Johnson,* 151 U.S. 81; *Texas & Pacific Railway Co. v. Bloom,* 154 U.S. 636; *Hanlon v. Smith,* 175 Fed. 492; Clark on Receivers (2d ed.) Sec. 494, p. 666; *Bartlett v. Cicero L. H. & P. Co.,* 177 Ill. 68, 52 N.E. 339, 341, 342; Glenn on Liquidation, Sec. 165, p. 273; *Stuart v. Dickinson,* 290 Mo. 516, 235 S.W. 446; *Anderson v. Chicago R. I. & P. R. R. Co.,* 189 Iowa 739, 175 N.W. 583; 45 Am. Jur. 276, Sec. 345.

[43]The provisions of Section 77 "carr[y] with [them] the application to railroad reorganizations of decisions and authorities originally applicable to equity receiverships." 5 Collier on Bankruptcy (14th ed.), p. 493.

makes no provision to free the assets from liabilities arising from the trustees' acts.[44]

Here the Assumption Agreement carried out the policy of the law. One of its necessary purposes and effects was to permit early personal discharge of the court's officers and to that end to permit claims arising from trustees' acts to be determined in independent suits after the bankruptcy proceedings had terminated.[45]

AN OBLIGATION TO PAY FOR RIGHTS OF ANOTHER SEIZED AND TAKEN QUIRED NO PRIOR APPROVAL OF THE BANKRUPTCY COURT.

The last opinion below also states "that any bargain that might have been effected at the time of the transaction would have been subject to approval of the bankruptcy court" (R. 2372). This remark cannot possibly have been directed to the 1944 return and the claim for refund, since they were filed after the revesting.

As to the 1943 return, while it may be true that court officers may not enter into express contracts without approval, failure to approve does not mean that the other party must transfer his rights for nothing. No bankruptcy court can dictate to one not in bankruptcy the terms on which he must transfer his property to a bankrupt's trustees (*Callaway v. Benton*, 336 U.S. 132). Nor may a court officer unilaterally take another's property, money, rights or other things of value to the enrichment of the estate and yet not subject the enriched estate to liability, merely because the court had not authorized him to enter into an express contract on the subject. *In re Hunter*, 151 Fed. 904; *Thompson v. Texas Mexican R. Co.*, 328 U.S. 134.[46] Court officers are peculiarly bound by obligations

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[44]Pertinent text of Section 77(f) is set forth in Appendix I hereto.

[45]It therefore is unnecessary to dwell on the further fact that the complaint herein stated that it was filed not only as an independent bill in equity but also as "an ancillary dependent suit within the jurisdiction reserved by this Court under its order dated March 28, 1946" in the bankruptcy proceedings (R. 6).

[46]A trust estate, enriched by unauthorized acts of the trustee, must account (Restatement of Trusts, Sec. 262; 2 Scott on Trusts, Sec. 269 to 269.3), as in the case of funds of another used to pay taxes on trust property (Restatement, Sec. 269, Comment a, Illustration 1). Cf. *Whiting v. Hudson Trust Co.*, 138 N.E. 33, 234 N.Y. 394 (per Cardozo, J.), and *Central Trust Co. of New York v. Ohio Central R. Co.*, 23 Fed. 306.

arising on principles of unjust enrichment, *Mosser v. Darrow*, 341 U.S. 267.

Moreover, an unauthorized act, if not binding on a receivership or estate, nevertheless creates a personal liability of the receiver or trustee. *Haines v. Buckeye Wheel Co.*, 224 Fed. 289, 297 (6 Cir.), cer. den. 242 U.S. 643; *In re Erie Lumber Co.*, 150 Fed. 817; 1 Gerdes on Corporate Reorganizations 617; 1 Clark on Receivers (2d ed.) p. 527. Hence, if any liability for tax savings relative to 1943 arose before the revesting, it was a liability of the trustees, and it became respondent's liability under the Assumption Agreement.

IV.

If An Issue of Fact Not Found on by a Trial Court Is Thought Material, the Cause Should Be Remanded for Findings Thereon. The Court Below Exceeded Its Appellate Office by Making Findings Ab Initio to Affirm the Judgment Upon a Legal Theory Different from That on Which the Trial Court Acted, and These Findings Were Contrary to What the Trial Court Made Clear It Would Have Found, Had It Considered the Issues Material, as Well as Contrary to Some Actually Made.

In its basic opinion of October 1951 the court below advanced as another ground of decision the factual assumption that petitioner, not respondent, filed the tax returns, and that respondent did not dominate and use petitioner's officers. Speaking of this, 65 Harvard Law Review at 1258 commented that the moment the issue of control is determinative "it would seem necessary for the court to have remanded to the district court for findings on that issue." Judge Fee had made the same protest, stating that "Findings must be made in the Trial Court. Appellate courts have no such right or function." (R. 2241).[47]

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[47]His dissent continued:

"The majority opinion attempts to accomplish justification of the result below by drawing inferences, deductions and conclusions from evidence which they claim to find in the record. * * * The very reason that Rule 52 requires findings of fact is illustrated by the majority opinion. For the technical difficulties of finding a basis of fact for this judgment are * * * insurmountable."

Our subsequent petition for certiorari and later brief in this Court in No. 150, Oct. Term 1952, discussed the subject fully.[48] In summary we noted the unprecedented nature of what the court below had done: An appellate court has power to reverse a judgment when it believes the findings to be "clearly erroneous." But this is not such a case, for it affirmed the judgment. An appellate court also has power to affirm a judgment on a legal theory different from that of the lower tribunal, if its new theory is supported by facts found below. But this is not that kind of case, either. Here an appellate court has swept aside the trial court's legal theories as unsound (R. 2227-2228, fn. 12, and see fn. 21 at p. 17, supra) and in nevertheless affirming it has done so on a theory presupposing facts upon which the trial court has not found and the very reverse of what that court, after hearing the witnesses and presiding over a living trial, has said it would have found had it deemed them material. "It is not the function of [an appellate court] to search the record and analyze the evidence in order to supply findings which the trial court failed to make." *Kelley v. Everglades Dist.*, 319 U.S. 415, 421; *Securities & Exchange Commission v. Chenery Corp.*, 318 U.S. 80, 88. A reversal should follow failure to find at all on an issue held to be material. *Interstate Circuit Inc. v. United States*, 304 U.S. 55.

The situation has now been aggravated. This Court directed the court below to reconsider our petition for rehearing. That petition had complained that the court had presumed to find facts. Yet, in its opinion again denying the rehearing—i.e., in the very course of denying any opportunity to the litigant to be heard *in any court whatever* with respect to findings on issues which the District Court thought immaterial—the court supports its action by encroaching even more sweepingly on the fact finding function.

After reasserting and extending its holding that petitioner was obligated to join in consolidated returns and to give the benefit of its loss to respondent gratis, the court bolsters its decision by stating (R. 2371):

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[48]See Appendix III hereto at pp. 15 to 21.

"The use of a right to set off by filing a consolidated return was the equivalent of a transfer voluntarily made, and was an executed contract."

This, of course, is simply an assertion that petitioner made a voluntary gift of its loss to respondent, knowingly and deliberately,[49] and therefore may not recover.

PETITIONER HAD NO POWER TO MAKE A GIFT.

This is "strange doctrine," as Judge Fee had called it when it was suggested but not yet fully asserted.[50] Petitioner is a corporation.[51] A corporation cannot make gifts of its propery (except in limited matters of public charities[52] or possibly in expectation of pecuniary benefit). Even a majority of the stockholders could not make a donation of all the corporate property (13 Fletcher

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[49]The opinion cites, as support, Restatement of Restitution, Sec. 1(c), p. 13. That citation relates to the case of "one who makes a gift or voluntarily pays money." The subject is expanded upon in Sec. 112, et seq., which relate to "benefits voluntarily conferred without mistake, coercion or request." Sec. 112, comment a, states that the rule underlying all examples of denial of recovery is the "principle that a person who *officiously* confers a benefit upon another is not entitled to restitution therefor." The Restatement emphasizes (p. 463) that "restitution should be granted in accordance with the principle that compensation for benefits conferred is denied only to officious intermeddlers or to persons who do not desire or who manifest no desire to have compensation for their services." And as said by the reporter of the Restatement, "In general one is entitled to recover for a benefit conferred unless he intended to make a gift or acted officiously." 2 Scott on Trusts, Sec. 269.3, p. 1520.

[50]He said (R. 2244): "* * * It seems to be assumed that the officers of plaintiff could give away the property right to file or refuse to file consolidated returns either voluntarily or acting under the control of defendant or the reorganization trustees. This is strange doctrine * * * a transfer of all the assets of a corporation * * * cannot be made even by a majority of the stock. Neither officers nor directors, without a vote of the majority, have such power. In this case it is of stellar importance that this right of plaintiff was its sole asset and that, upon appropriation thereof, it became insolvent."

[51]The cases cited by the court below, in its last opinion, *Shelley v. Board of Trade*, 87 Cal. App. 344, 262 Pac. 403, and *McMillan v. O'Brien*, 219 Cal. 775, 29 Pac. 2d 183, are simply cases of voluntary payments by individuals.

[52]Cf. Del. Corp. Law. Sec. 2(9), now 8 Del. Code, Sec. 122(9); Cal. Corp. Code, Sec. 802(g).

Cyc. Corp., 1943 Rev. ed., Sec. 5789, p. 103); "it is not for trustees to be generous with other people's money" (Ballantine on Corporations (1946), p. 228); "the majority stockholders have no power to give away corporate property against the protest of the minority" (*Rogers v. Hill,* 289 U.S. 582, 591; *Nemser v. Aviation Corp.,* 47 F. Supp. 515). *A fortiori,* corporate officers can make no gifts.

Moreover, the tax utility of petitioner's loss was substantially its only asset, and not even a corporation's Board of Directors, much less its officers, can transfer all or substantially all of its assets, even for consideration; approval of requisite proportions of the stockholders is required (Del. Corp. Law, Sec. 65; now 8 Del. Code Sec. 271). Even then the fairness of the transaction is subject to judicial inquiry. "The price to be paid * * * and such like questions, must all meet the test of the corporation's best interest." *Allied Chemical & Dye Corp. v. Steel & Tube Co.,* 14 Del. Ch. 1, 120 Atl. 486, 490, 491, 494; *Allaun v. Consolidated Oil Co.,* 16 Del. Ch. 318, 147 A. 257, 260, 261.[53]

Still other statements in the last opinion below seem unmindful of what one would suppose to be elementary law. For example, it is said (R. 2370):

> "It must be borne in mind that all the transactions were open and aboveboard and were carried on in plain sight of all concerned * * *"

This is not merely a "disintegrating erosion" of basic duties of fiduciaries condemned by equity (Cf. Cardozo, J. in *Meinhard v. Salmon,* 164 N.E. 545, 249 N.Y. 458); it is a shattering disruption. Trespassers and converters are not immune from liability because their trespass or conversion is open: "The publicity alone of an illegal and unauthorized act of the directors of a corporation does not make it legal or valid. * * * Trustees may [not] validate an illegal act by simply doing it openly." *Goodell v. Verdugo Canon Water Co.,* 138 Cal. 308, 314, 71 Pac. 354, 356.

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[53]Since petitioner is a Delaware corporation, we cite Delaware law. The rule, however, is general. Cf. Cal. Corp. Code, Sec. 3901.

In fact, respondent's conduct in taking and using petitioner's tax rights can be called "open and aboveboard" only in the sense that it resorted to no devices of concealment. But it did not disclose what it was doing to petitioner's board or any responsible disinterested officer owing no loyalties to respondent itself (See pp. 5, 6, supra). And if it be assumed that "in failing to claim for plaintiff the advantages of its position," those responsible acted "without improper intent," this, as Mr. Justice Jackson said, does not free respondent of the duty to account (345 U.S. at 377).

THE ASSERTION THAT PETITIONER MADE A GIFT IS AN INTRUSION ON THE FUNCTION OF FACT FINDING.

Moreover, it simply is not the fact that petitioner, a corporation, voluntarily transferred to respondent the use of its loss by way of gift. Respondent simply took that benefit. The trial court stated in its opinion that "* * * there is a preponderance of the evidence in favor of the plaintiff's contention of 'duality of control.'" (R. 272). And by "duality of control" it said that it referred to the allegations of the Supplemental Complaint

> "that the defendant through its officers and attorneys had controlled the board of directors of the plaintiff corporation and that by reason of such control plaintiff was caused to file the consolidated returns for the benefit of the defendant." (R. 264)[54]

Thereafter, on settlement of the findings, the trial court agreed that respondent and not petitioner had conducted the tax proceedings and had achieved this through control of petitioner. *"There is no question about that,"* it said (R. 468).

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[54]The last opinion of the court below comments (R. 2369, fn. 8) that petitioner's answer to a complaint in intervention denied all allegations of domination and control. The allegations so denied had been made by certain stockholders seeking to intervene on the charge that petitioner would not properly press this case. Subsequently petitioner filed its Supplemental Bill of Complaint (R. 208) in which it affirmatively alleged the existence prior to commencement of the suit of such domination and control for respondent's benefit and in disregard of petitioner's rights. This is the allegation which the trial court stated was supported by a preponderance of the evidence.

The trial court declined to embody these statements in formal findings simply because it refused to make findings on any fact not material to the reasoning on which it based its decision (R. 276).

If, under the different reasoning of the appellate court, the facts become material, there should be findings by the tribunal authorized by law to make findings.

CONCLUSION

We respectfully submit that this petition for certiorari should be granted and the judgment reversed with directions to enter judgment for petitioner.

Dated: San Francisco, California, October 23, 1953.

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(Appendices follow)